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RUEHRG/AMCONSUL RECIFE 4576  
RUEHSO/AMCONSUL SAO PAULO 6697  
RUEHRI/AMCONSUL RIO DE JANEIRO 1834  
RUEHBU/AMEMBASSY BUENOS AIRES 3931  
RUEHSG/AMEMBASSY SANTIAGO 5434  
RUEHAC/AMEMBASSY ASUNCION 5349  
RUEHMN/AMEMBASSY MONTEVIDEO 6176  
RUEHME/AMEMBASSY MEXICO 1955  
RUEHCV/AMEMBASSY CARACAS 3192  
RUEHBO/AMEMBASSY BOGOTA 3675  
RUEHQT/AMEMBASSY QUITO 1781  
RUEHLP/AMEMBASSY LA PAZ 4489  
RUEHPE/AMEMBASSY LIMA 2928  
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SUBJECT: BRAZIL - NEW FINANCE MINISTER'S EARLY CHOICES REASSURE  
MARKETS

REF: A) BRASILIA 609 B) BRASILIA 640

11. (SBU) Summary. New Finance Minister Guido Mantega has moved cautiously in his early days on the job, reassuring financial markets. His choices for Vice Minister and Treasury Secretary, Bernard Appy and Carlos Kwall, respectively, have been well received. On March 31, Mantega supported a measured, 85-basis point reduction in the interest rate that his former employer, the National Economic and Social Development Bank (BNDES), charges on its lending. Separately, President Lula stated that the Central Bank would now report directly to him, instead of the finance minister, in a maneuver designed to keep Central Bank President Meirelles from leaving. The carefully calibrated moves appear to have mitigated concerns about the direction of economic policy in the near term. Indeed, at an April 4 Sao Paulo lunch, the chief economists of several banks told visiting Treasury Assistant Secretary for International Affairs, Clay Lowery, that they expected

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no changes in macroeconomic policy from Mantega for the remainder of Lula's term, or even in a potential second Lula administration. End Summary.

Reassuring Personnel Choices  
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12. (SBU) New Finance Minister Guido Mantega on March 30 named Bernard Appy, currently the finance ministry's Economic Policy Secretary, to be his Vice Minister (or in the Brazilian lexicon,

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Executive Secretary), replacing Murilo Portugal, who resigned immediately after Antonio Palocci's dismissal from the ministry. Appy is a well-regarded technocrat who served as Palocci's Executive Secretary for two years, before taking over the economic policy

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secretariat after the former incumbent, Marcos Lisboa, departed.

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Appy never maintained a high profile in either of his ministry jobs, but his orthodox policy credentials are well known to financial market participants. Appy, for instance, was the sounding board of first recourse for Palocci, a medical doctor by training, as he dealt with more complex economic issues.

13. (SBU) Mantega also named Carlos Kawall to the key position of Treasury Secretary, taking the slot vacated by Joaquim Levy, who departed to work at the Inter-American Development Bank (IDB). The appointment was closely watched by the markets as the official filling that post is charged with doling out funding to the various ministries and is thus crucial to fiscal policy execution. During his tenure at the finance ministry, Levy had developed a particularly strong reputation as a bulwark against fiscal irresponsibility. Indeed, Levy was the driving force for the GoB's over-performance, by large margins, of its primary surplus targets. Previously, Kawall worked for Mantega as a director at BNDES. Financial market players are familiar with Kawall from his prior work as chief economist for Citibank's Brazil operations. In a March 17 conversation with Econoff (prior to the announcement), a CSFB economist concluded that Kawall would be a sterling choice. Separately, prominent fiscal expert Raul Velloso evaluated Kawall as having much the same orthodox policy credentials as Levy. Revenue Secretary Jorge Rachid also will remain on the job.

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#### Cautious Choice on Long-term Interest Rate

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14. (U) In another closely watched decision, the National Monetary Council (CNM), in its first meeting chaired by Mantega, voted unanimously to lower the interest rate on BNDES loans (the TJLP) by 85 basis points, from 9% to 8.15%. Mantega's recent job change put him in the unique position of having to vote on his own proposal, made as BNDES President, to reduce the TJLP by 2 percentage points. (Note: All proposed changes in the TJLP must be approved by the CMN, which consists of the Finance Minister, Planning Minister Paulo

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Bernardo and Central Bank President Meirelles.) Given Mantega's previous criticisms of administration monetary policy, the markets saw the meeting as a bellwether of Mantega's intentions. In the event, the CMN voted unanimously for a measured 85-basis point reduction, a drop that does not quite keep pace with recent Central Bank reductions in the benchmark overnight interest rate (SELIC).

#### Central Bank President Stays

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15. (SBU) On March 28, the day after Palocci resigned, President Lula organized an effort to keep Central Bank Chairman Meirelles from leaving. A Central Bank staffer assured Econoff that the media was exaggerating the extent of previous interest rate policy battles between the Central Bank and Mantega dating back to the latter's tenure both at BNDES and as planning minister. Meirelles reportedly nevertheless felt it necessary to obtain guarantees from President Lula about continued policy independence of the Central Bank. Lula agreed that the Central Bank would now report directly to him, instead of the finance ministry.

#### Bankers to A/S Lowery: "no change"

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16. (SBU) In an April 4 Sao Paulo luncheon, senior economists from several banks told visiting Treasury A/S Clay Lowery that they expected Mantega would not change macroeconomic policy prior to the elections, or even in a potential second Lula administration. Bank Boston Chief Economist Jose Pena Garcia elaborated that while he did not expect Mantega to pursue primary surpluses in excess of the formal 4.25% of GDP target, as Palocci's finance ministry had done,

he believed Mantega would strive to meet the 4.25% target. Echoing this assessment, Alexandre Bassoli of HSBC Bank stated that while Lula might make some personnel changes among the directors of the Central Bank were he reelected, these moves would not affect the Central Bank's "conservative" monetary policy stance.

¶7. (SBU) Comment: The GoB's careful scripting of Mantega's first days/week appears to have successfully conveyed the policy-continuity message. The real, after initially dropping 2.7% to 2.23 Reais/Dollar in the wake of Palocci's departure, has now made up the lost ground and is trading at about 2.13 Reais/Dollar as of mid-day April 5. The fact that the GoB was forced to undertake a rear-guard action to ensure Meirelles stayed on, however, reinforces the case for formal legislation establishing Central Bank independence. But we do not expect that this or any other microeconomic reform legislation will make it through Congress during this electoral year.

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